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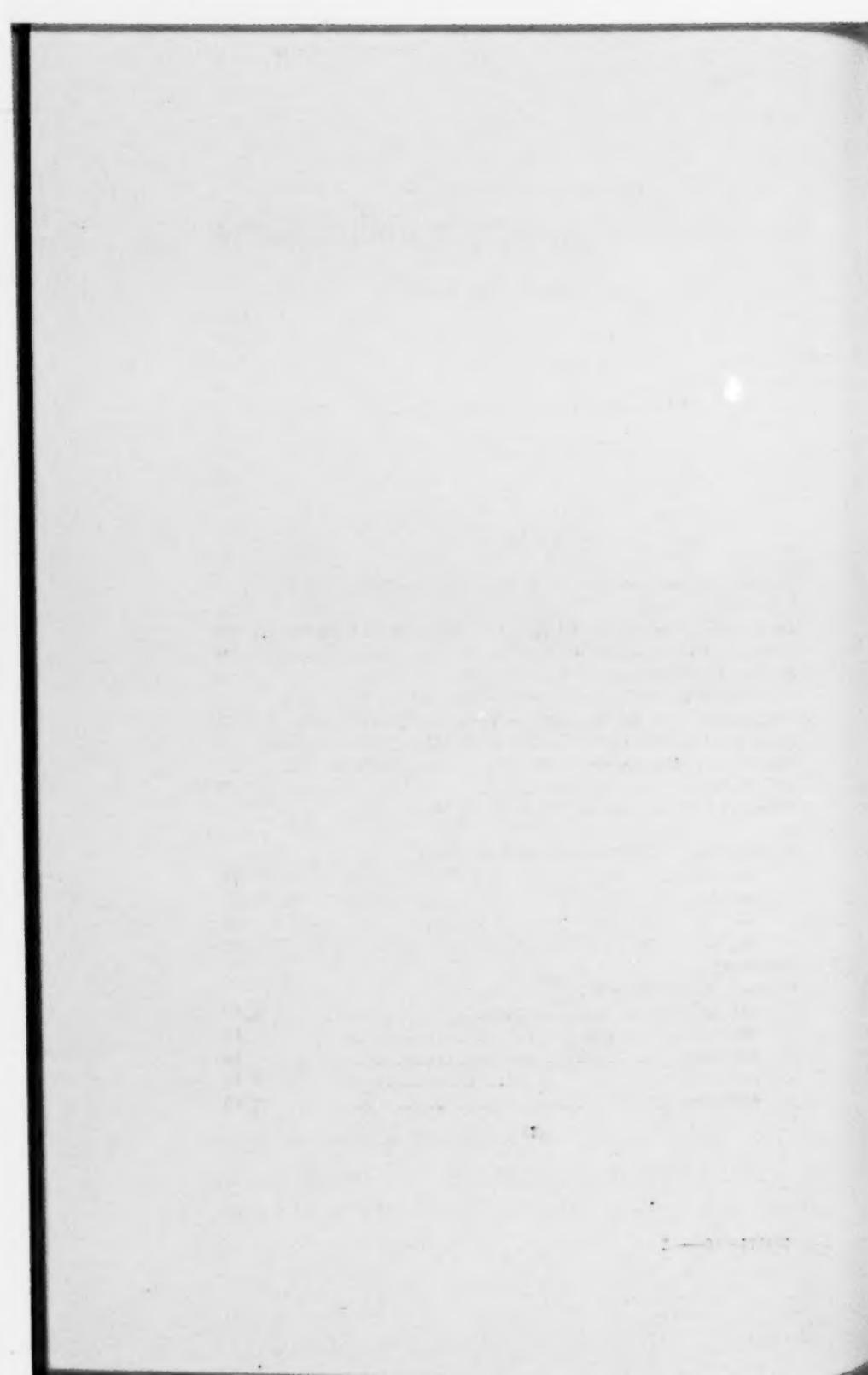
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In the Supreme Court of the United States

OCTOBER TERM, 1942

—
No. 1018

THE L. A. WELLS CONSTRUCTION COMPANY,
PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL
REVENUE

—
*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH
CIRCUIT*

—
BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 10-18) is reported in 46 B. T. A. 302. The Circuit Court of Appeals promulgated no formal opinion.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on February 11, 1943 (R. 27). The petition for a writ of certiorari was filed on May 10, 1943. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended.

QUESTION PRESENTED

Whether the Circuit Court of Appeals correctly sustained the Board of Tax Appeals' determination that the taxpayer kept its books and reported its taxable income on the completed-contracts basis, and therefore was not entitled under Section 41 of the Revenue Act of 1936 to deduct in the taxable year, 1937, an amount estimated and set up in a reserve as an accrued loss upon a contract begun in that year, and completed less than 12 months later in the following year.

STATUTE AND REGULATIONS INVOLVED

The pertinent statute and regulations involved are set forth in the Appendix, *infra*, pp. 11-16.

STATEMENT

The facts found by the Board of Tax Appeals may be stated as follows (R. 11-15):

Since 1926 petitioner has been engaged principally in marine construction work embracing dredging, the building of breakwaters, and the performance of subaqueous work of all kinds, and filed its income tax returns on the calendar year basis. During this period petitioner has undertaken on an average of from 45 to 50 projects annually. Prior to 1935 all projects begun during a given year were completed within that year. In 1935 it began one project which was not completed until the succeeding year. In 1936 it began four projects which were completed in 1937. In 1937

it began two projects which were completed in 1938. So far as disclosed, none of the contracts under which projects were begun in one year and completed in the following year contemplated or required a period in excess of 12 months for completion. (R. 11-12.)

One of the projects begun in 1937 and completed in 1938 was the construction of an intercepting sewer and sewage treatment project at Buffalo, New York, sometimes referred to as the Buffalo project. The contract for the project was with the Buffalo Sewer Authority, and was approved on August 14, 1937. It provided for the completion of the project in 225 consecutive calendar days from the date of notice by the Authority to proceed with the work, unless such period should later be extended by the Authority. The specifications and contract contemplated completion of the project as a whole, and that was the petitioner's understanding in submitting its bid. The project was shown, however, in 17 separate items; payments as to four were to be made on the lump sum basis, while as to the others payment was to be made at a unit price. At the time the petitioner entered into the contract, it was estimated that the total amount to be received for the completion of the project would be \$382,249.02, and the performance bond given by the petitioner to the Authority was for that amount. (R. 12.)

The petitioner began work on the Buffalo project on August 16, 1937, and completed it on or

about July 10, 1938. Under the contract the petitioner received monthly payments from the Authority based on progress estimates made by the engineers for the Authority, which in turn were predicated upon the work done and materials furnished. During November 1937 the petitioner encountered subsurface difficulties which resulted in greater labor and material costs than it originally had anticipated. By December 31, 1937, the progress estimates made by the Authority's engineers indicated that the project was 46.96% completed and totaled \$182,189.62. By that time the petitioner's labor costs had amounted to \$100,349.18 and its total costs to \$244,369.30, or \$62,179.68 in excess of the total of progress estimates. After it had encountered the unanticipated difficulties, the petitioner filed complaints with the Authority as the work progressed, in order to lay a basis for a formal claim if it should later decide to make a claim for compensation in excess of that provided for in the contract. Under the existing contract, however, the responsibility for judging the sufficiency of its estimates of costs and conditions affecting the execution of the project rested entirely on the petitioner. No formal claim for additional compensation was filed in 1937, but in 1938, when the work was completed, the petitioner did file with the Authority formal claim for compensation beyond that provided in the contract to cover the unanticipated costs it incurred in com-

pleting the project. In final settlement the Authority, without the contract so providing, paid the petitioner approximately \$24,000 in addition to the \$382,249.02 originally estimated to be paid under the contract. The petitioner's loss on the project after making allowance for the receipt of the \$24,000 was \$95,343.26. (R. 12-13.)

On or after December 31, 1937, the petitioner debited an account on its books designated "Cost of Jobs—Miscellaneous" with an amount of \$61,031.40, with the following explanation (R. 13-14):

Buffalo Sewer Authority Job in progress as of	
December 31, 1937—Cost	\$244, 369. 30
Estimates allowed on 46.96% of project completed	
to December 21, 1937	182, 180. 62

Cost is 134% of estimates allowed.

Completed contract price is \$382,249.02. Continued loss at 134% would cost \$512,213.68 to complete, causing a loss of \$129,964.66.

46.96% of \$129,964.66 represents known loss as of December 31, 1937.

In its income tax return for 1937 the petitioner deducted as a reserve for loss on the contract the \$61,031.40, computed in the foregoing manner (R. 14).

With respect to projects begun in one year and completed in the subsequent year, even though on a unit price basis, it has been the practice of the petitioner to enter currently on its books the receipts from such projects and the expenditures incurred thereon, but under the method of accounting employed by it the profit or loss on such projects was not reflected in its income until the

year of completion of the projects. It has been the practice of the petitioner in filing its income tax returns to report in the year of completion the gain or loss resulting from projects begun in the preceding year and completed in the current taxable year. (R. 14.)

In conformity with that practice, the petitioner in filing its 1937 return completely ignored the Buffalo project so far as income and expenditures were concerned, except to deduct as a reserve the \$61,031.40. In its income tax return for 1938, the petitioner showed the total receipts and the total expenses of the Buffalo project and from the expenses subtracted the \$61,031.40 taken in its 1937 return, thereby taking as a loss in 1938 on the project the difference between \$95,343.26, loss actually sustained, and \$61,031.40, deducted as a reserve in 1937, or the amount of \$34,311.86. After thus taking the \$34,311.86 as a loss, the petitioner reported a loss in 1938 of about \$20,000. (R. 14.)

In sustaining the Commissioner's disallowance of the deduction of \$61,031.40, the Board of Tax Appeals found that the taxpayer accounted for and reported its income by the completed contract method (R. 16). It concluded that to permit a departure would result in the taxpayer's income not being computed "in accordance with the method of accounting regularly employed" in keeping its books, as required by Section 41 of

the Revenue Act of 1936, and would result in a distortion of income for both 1937 and 1938 (R. 16). The Circuit Court of Appeals entered a judgment of affirmance "upon the grounds and for the reasons set forth in the opinion of the Board" (R. 27).

ARGUMENT

The Board's finding that the petitioner accounted for and reported its income upon the completed contract method was based on the testimony of the latter's secretary-treasurer who had charge of its books (R. 16). The petitioner insists that the finding is erroneous (Br. 12), but it did not request that the evidence taken in the case be transmitted to the Circuit Court of Appeals (R. 24); upon review, therefore, there was no basis upon which it could be concluded that the Board's finding was not supported by substantial evidence. Cf. *Badgley v. Commissioner*, 59 F. 2d 203 (C. C. A. 2d); *Tricou v. Helvering*, 68 F. 2d 280 (C. C. A. 9th), certiorari denied, 292 U. S. 655.

As the Board concluded, the deduction claimed by the petitioner for 1937 clearly constituted a departure from the completed contract method of accounting. Under this method, the entire loss on the contract would be taken in 1938. Instead, the loss is sought to be spread between the two years 1937 and 1938. To permit such a change

with respect to this particular contract would plainly result in a distortion of income for the years involved. It would directly contravene both the clear language of the statute and the provisions of the applicable regulations. Revenue Act of 1936, Section 41; Treasury Regulations 94, Article 41-1 (*Appendix, infra*).

The petitioner, as we understand its argument (Br. 13-17), also contends that it could not be held to the completed contract method of accounting because the regulations provide for its use only in connection with long-term contracts, which are defined as contracts covering a period in excess of one year, and it does not appear that the petitioner's contracts contemplated more than 12 month periods. Treasury Regulations 94, Article 42-4, *Appendix, infra*. The petitioner also contends that in any event it cannot be held to that method of reporting income on this particular contract which was of less than 12 months' duration. (Br. 17.) But there is nothing in the regulations to prevent a taxpayer from adopting a method of accounting by which income from contracts begun in one taxable year and completed in another would consistently be returned in the year of completion of the contracts although some or all of the individual contracts would be completed in less than a single year. Indeed, the regulations specifically point out that no uniform method

of accounting can be prescribed for all taxpayers, and that each taxpayer shall adopt such forms and systems of accounting as in his judgment are best suited to his purpose. Treasury Regulations 94, Article 41-3, Appendix, *infra*. The test is whether the method consistently followed will clearly reflect income.¹ It appears here that both the Commissioner and the Board thought that it did (R. 16). Plainly, there was no occasion to disturb this determination upon review.² Cf. *Brown v. Helvering*, 291 U. S. 193, 204-205; *Lucas v. American Code Co.*, 280 U. S. 445, 449.

¹ Cf. *Bent v. Commissioner*, 19 B. T. A. 181, affirmed, 56 F. 2d 99 (C. C. A. 9th); *Badgley v. Commissioner*, 21 B. T. A. 1055, affirmed, 59 F. 2d 203 (C. C. A. 2d); *Fort Pitt Bridge Works v. Commissioner*, 24 B. T. A. 626, affirmed on this point, 92 F. 2d 825 (C. C. A. 3d), certiorari denied, 303 U. S. 659; *Finn v. Commissioner*, 22 B. T. A. 799; *Wheelock v. Commissioner*, 10 B. T. A. 540.

² The Commissioner's determination could also be sustained on the alternative ground that the deduction was not allowable since it was not evidenced by a closed and completed transaction (Treasury Regulations 94, Article 23 (e)-1, Appendix, *infra*) but represented mainly an estimated contingent liability.

CONCLUSION

The decision of the court below was correct. There is no conflict. The petition for certiorari should be denied.

Respectfully submitted.

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